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NOTES

WASHINGTON NOTES

A NEW SYSTEM OF NATIONAL TAXATION

Secretary of the Treasury McAdoo has sent to Congress in his annual report a review of the revenue situation which outlines the plans of the present administration with reference to modes of preparing for war necessities, and which is, therefore, likely to be of historic interest. Should the plans of the administration be accepted by Congress, and the methods of raising revenue outlined in this Treasury report be adopted, the nation will have definitely embarked upon a new era of financial administration. Even should the plans of the administration be rejected or discarded by Congress, the recommendations of the report will still mark a turning-point in the management of the nation's finance.

The striking feature of this year's finance report is the fact that, although a deficit of probably about \$75,000,000 for the remainder of the current fiscal year, and a probable deficit of about \$250,000,000 for the following fiscal year (ending June 30, 1917), are recognized, or a total of \$325,000,000, it is urged that the nation should adhere to the policy of taxation for the purpose of providing for its necessities, and should not fall back upon the issue of bonds, even to the extent of reimbursing itself for outlay on Panama Canal account, for which Congress has already authorized in past years the sale of such bonds:

. . . . no part of these expenditures should be provided by the sale of government bonds, with the possible exception of the payments for the Panama Canal. Even as to the Panama Canal it seems to me wise to continue to provide for its necessities out of the revenues of the government. The larger part of the canal expenditures is already behind us, and we should look for diminishing demands from the Canal in future years. The policy of providing for the expenditures of the government by taxation and not by bond issue is undoubtedly a sound one and should be adhered to. A nation, no more than an individual, can go constantly into debt for current expenditures without eventually impairing credit. A wise, sound, and permanent policy of raising the additional revenues required for preparedness and the expenditures of the government should therefore be devised and adopted.

That is to say, the program of national defense and preparation for war is distinctly placed upon a footing of payment out of current income. It should be borne in mind that in order to keep the deficit down to even

these limits it will be necessary that the present tariff on sugar, and the stamp taxes imposed a year ago, should be maintained in existence. As will be remembered, the tariff on sugar, under the terms of the Underwood act, was to expire on May 1, 1916, while the stamp taxes were to expire at the end of December, 1915. Should there be difficulty in securing extension of these taxes, the anticipated deficit would be probably \$60,000,000 larger than is indicated by the figures already cited.

It is, therefore, a fundamental idea of the new program that the duty on sugar and the war revenue tax should be extended. To provide for the new requirements of national defense amounting, as estimated, to \$325,000,000, entirely new and additional measures are suggested. First of all, it is recommended that the income tax be greatly broadened, and in this connection interesting light is thrown upon the present working of the Income Tax act. Next it is suggested that additional taxes be called into play for the purpose of raising further revenue, the chief proposal in this connection being the imposition of taxation on gasoline, crude and refined oils, horse-power of automobiles and of internal combustion engines, as well as on pig iron and other items of like character. The increase in rates of taxation on individual and corporate incomes is, however, plainly relied upon as the chief source of new revenue, as it is suggested that the present exemption of individual incomes be reduced by \$1,000, and that the point at which the present "surtax" begins be lowered by \$5,000 or \$10,000.

As already intimated, the notable outcome of these plans, should they be adopted, would be that of definitely placing the government of the United States upon a basis of direct taxation instead of, as heretofore, upon the indirect revenue footing. The beginning in this direction was made at the time of the adoption of the Payne-Aldrich tariff law when the corporation tax was adopted as a national resource. The action of Congress in the Underwood-Simmons act adding the individual income tax further confirmed the tendency toward direct taxation. Undoubtedly there has been expectation on the part of many that certainly the individual income tax, and perhaps the corporation income tax, would, at no distant date, be repealed, such action being rendered easily possible through the growth of customs revenue. While the Secretary of the Treasury recognizes that the closing of the European war will undoubtedly enlarge customs revenues, it is evident that they would not soon recover their wonted amount, and even if they should do so, the additional military outlay of perhaps \$250,000,000 a year, on the average, would require a regular resort to some other method of obtaining income.

THE RAILWAY-MAIL PAY SITUATION

It is already evident that at the session of Congress which has just opened the question of railway-mail pay will be presented with practically the same intensity of feeling on both sides that was manifested a year ago. No new official investigation has been made since the last session of Congress, so that the situation remains on the same basis as then.

In the last annual report of the Postmaster-General was set forth the status of the proposed legislation for fixing railway-mail pay and the problem was fully reviewed at the time in this *Journal*. The features of the plan favored by the Post-Office Department and that proposed by the Joint Committee of Congress on Mail Pay were then described and contrasted. Subsequently the department's plan was introduced in the House of Representatives as a section of bill H.R. 17042, which was favorably reported and finally passed, but upon which the Senate failed to act. The joint committee's recommended legislation submitted in its report was introduced in the Senate as bill S. 6405. Following the introduction of that measure, the Senate Committee on Post Offices and Post Roads gave hearings to representatives of the Post-Office Department on the House bill and to representatives of the railroad companies upon the provisions of the two bills before it. No report, however, was made to the Senate by the committee. Subsequently the House Committee on Post Offices and Post Roads embodied in the Post-Office appropriation bill for the fiscal year of 1916 the department's proposed plan for regulating railway-mail pay, together with other remedial legislation advocated by postal officials. The House of Representatives passed the bill in its entirety; but as the Senate refused to concur, the bill was sent to conference, and after a long discussion an agreement was reached for the submission of a conference report embodying substantially the department's plan, but with amendment and with an additional provision to the effect that after the new rates should have been in operation for two years, the question of their adequacy or inadequacy might be presented to the Interstate Commerce Commission upon request of the Postmaster-General or of representatives of railroad companies operating at least 51 per cent of the mileage of railroads over which mail service is performed. This conference committee report was submitted to the last Congress in its closing hours but failed of passage. It was hence necessary for both Houses to pass a joint resolution making the amounts of appropriations for the fiscal year 1915 available to meet the obligations of the department during the fiscal year 1916.

The plan which is this year again urged by the Post-Office Department is substantially that of substituting a space basis of payment for mail transportation in the place of the present weight basis with quadrennial weighing. It is the feeling of the railroads that the proposed plan is defective and injurious in two particulars: (1) that the rates of compensation are not adequate; (2) that the establishment of them places too much power in the hands of officials who may have an undue bureaucratic tendency. They therefore ask for a rectification of the present methods of weighing and compensation, but without the substitution of the new space basis in place of the old one.

An extensive propaganda or agitation intended to represent the point of view of the railroads has been carried on during the past few months, the purpose being to secure a more considerate adjustment of relations between the government and the carriers than the department has as yet seemed willing to concede. The situation is rendered more difficult by the rapid growth of the parcel-post system, which greatly complicates the mail-pay question. At present small additional allowances for the carriage of parcel-post matter on certain roads are permitted under existing law, but upon a sporadic and irregular basis which admittedly does not meet the requirements of the situation. Owing to the failure of Congress to act on the mail-pay question at the last session no action was taken with reference to a special increase for parcel-post service which had been recommended by the Postmaster-General more than a year ago. This makes the whole question of mail pay increasingly urgent from a railroad standpoint because of the gross deficiency of remuneration which becomes more and more marked as the parcel-post system extends its scope and to an increasing degree supersedes express service.

A NEW PERIOD OF RAILROAD REGULATION?

A new stage in the history of railroad regulation in the United States has probably been opened by the action of President Wilson in recommending in his message to Congress (Annual Message, December 6, 1915) the creation of a railroad commission whose function it will be "to ascertain by a thorough canvass of the whole question whether our laws, as at present framed and administered, are as serviceable as they might be in the solution of the [railroad] problem." This suggestion comes as the climax of the long period of uneasiness which has existed ever since 1910, when the original application of the railroads for an advance in rates was before the Interstate Commerce Commission.

It will be remembered that at that time a reorganization of the Commission took place, the then chairman being transferred to the newly organized Commerce Court, while new appointments to the Commission established a majority in the hands of the so-called "radicals." The application of the roads for an advance in rates was definitely declined. In the 5 per cent rate advance case of 1914, the old issue was renewed, and the struggle this time led to a partial concession of the advance asked for, notwithstanding that the Commission in its first decision refused the application of the carriers, only to reverse itself in part within a few months. Finally in passing upon the application of the western roads for a general advance in rates, decided in the summer of 1915, the difference of view which had developed in the Commission with reference to the status of the railroads was plainly exhibited through the filing of majority and minority opinions. Most of the advances, however, were disapproved. Two vacancies had meanwhile been created in the Commission, and these places had been filled by the present national administration. Meanwhile, also, very important action had been taken by the Commission in depressing express rates to such an extent as to lead one large company to abandon the business entirely, while the introduction of the parcel-post system had furnished an active source of competition in the transportation of certain classes of matter. The continuous anxiety with reference to the ability of many well-known roads to meet their fixed charges and yet be able to pay anything to stockholders has been partially relieved since the development of the present immense export trade, but the general opinion of well-informed observers undoubtedly is that this is a temporary improvement only. Consequently it may fairly be said that the question is now acute: What shall be the policy of the federal government toward the roads in the future, and by what instrumentalities shall that policy be carried out? The opening of Congress has offered opportunity for definite action on the whole subject, and the following points, among others, are covered in legislation either already introduced, since the beginning of the session, or in process of preparation: (1) whether the Interstate Commerce Commission itself should be enlarged with a view to rendering it more efficient and its decisions more prompt; (2) whether there shall be a new definition of the rate-making power of the Commission with a view to prescribing general principles of rate-making, it being felt by many that the opinions of the Commission have not thus far followed a consistent policy; (3) whether the power to establish minimum as well as maximum rates shall be granted the Commission;

and (4) whether before taking these or any other steps there shall be a commission of inquiry, as suggested by the Executive, for the purpose of reviewing the whole situation.

The railroad situation is admittedly growing more and more difficult from many different standpoints. Advances in rates, when granted, as experience during the past few years has shown, are by no means always beneficial to the roads, inasmuch as the highly organized labor bodies, including practically all classes of employees, promptly succeed in getting a substantial part of the added revenue, being aided in such efforts by the rapidly developing federal system of mediation and arbitration. On the other hand, the rise of interest which is resulting from the European war and from other influences is rendering capital very much more costly for the roads, while the best expert opinion seems to be to the effect that the density of traffic cannot be very much added to without a disproportionate increase of danger. In support of this fact is the apparent congestion of the eastern railroads existing at the present time, and largely due to the heavy export movement. The fair conclusion seems to be that little help can be derived by the railroads at present from the operation of the "law of increasing returns" in transportation. An advance in rates which will provide some means of insuring the retention of the results of rate advances in the railroad business in order to insure reasonable extension of facilities and reasonable access to new capital seems to be the only means of resolving the difficulty. Opposed, however, to any legislative measures designed to work toward such an end is the so-called radicalism which still exists in very positive form throughout large sections of the country, and the consequent unwillingness to permit any bettering of the carrier's position. To sum up, the railroad-regulation system, as at present applied by the federal government, is reaching an *impasse*, while the further extension and improvement of transportation is evidently dependent in no small degree upon a better economic status for the carriers. President Wilson's request for a commission of inquiry opens the way to a general study and analysis of the condition arrived at after about twelve years of severe railroad regulation. Nevertheless, the present temper of Congress makes it at least doubtful whether even this step toward a solution can be taken immediately.

BROADENING THE RESERVE BANKS

The Federal Reserve Board has taken a further step toward the broadening of the functions of the reserve system by issuing, under date of November 29 and December 6, Circulars No. 19 and 20, respectively,

the first relating to open-market purchases of bankers' acceptances, the second to open-market purchases of foreign and domestic bills of exchange. Circular No. 19, which deals with bankers' acceptances, is an enlargement and modification of previous circulars on that subject, the difference being that authority is now given to federal reserve banks to purchase in the open market, not only those bankers' acceptances which grow out of import and export transactions, but also those which result from domestic transactions. As will be remembered, the Federal Reserve act gave to the national banks the power to accept only in cases where the transaction had to do with import and export transactions; but a number of states have since then passed legislation permitting state banks to accept generally—that is to say, to accept for transactions growing out of purely domestic shipments. The laws of other states are such as not to prohibit such acceptances, and there is a constantly increasing volume of accepted bills growing out of such domestic operations. To this market for paper the federal reserve banks are now, by the terms of the new circular, admitted.

Circular No. 20, relating to domestic and foreign bills of exchange made by individuals or corporations, permits federal reserve banks to buy practically any class of paper, whether accepted or unaccepted, which takes the form of a bill of exchange—that is to say, an unconditional order in writing addressed to an individual, firm, or corporation, and calling for the payment of funds at a designated date in the future. It is true that thus far no federal reserve banks have entered the foreign field or established agencies abroad; but the new circular provides that they may do so subject to the consent of the Board. When such arrangements have been made, the banks will be in position to transfer money by cable, and consequently Circular No. 20 provides for business in cable transfers, a function expressly recognized by the Reserve act. In this connection the Board says:

The Federal Reserve Board realizes that in dealing in foreign exchange the federal reserve banks must necessarily have wide discretion in determining the rates at which they will buy or sell. It is not necessary that the bills shall have been actually accepted at the time of purchase. The Federal Reserve Board, however, will require that unaccepted "long bills," payable in foreign countries, when purchased, unless secured by documents, shall bear one satisfactory indorsement other than those of the drawer or acceptor, preferably that of a banker. Federal reserve banks should exercise due caution in dealing in foreign bills, and boards of directors should fix a limit within which the acceptances or bills of a single firm may be taken.

While it is uncertain at how early a date the federal reserve banks will think it wise to enter the foreign field on account of the generally disturbed conditions existing abroad, the Board has now by its regulation definitely opened to the banks as large a scope of business as they may care to undertake, and the degree of their exploitation of it is entirely a matter for the several banks to determine upon. As is noted in the circular accompanying the regulations, it was the intent of the Federal Reserve act to enable the reserve banks to engage in open-market business, partly for the purpose of making their rates effective and partly to enable them to earn their expenses and dividends. Up to the first of October, federal reserve banks as a unit had covered current expenses and about \$320,000 in addition, some of the individual banks making dividends, while others had not covered all current expenses for the year. The question of enlarging their earnings to the desired amount is now a matter of banking judgment. Under the new provision one bank (Atlanta) has established an open-market rate for domestic bills of exchange of $3\frac{3}{4}$ per cent as a minimum, while it has applied to the domestic bankers' acceptances the same rate already effective for import and export acceptances, viz., 2 per cent to 4 per cent. The action taken is of special importance because of the discussion that has been in progress in some quarters with reference to the question whether federal reserve banks are merely emergency institutions or are to be regularly and continuously operated. It is the open-market section of the law which, more clearly than any other, indicates the belief of the framers of the act that the reserve banks were to be regularly and continuously carried on, so that the issuance of the new regulations putting this section into effect and enabling the reserve banks to name rates at any time definitely accepts that view which considers it the function of the reserve institutions to adopt and apply a known discount policy, employing their resources, whenever wise, in the general purchase of paper.

It may be said that, with the issuance of these two regulations, the discount and commercial paper features of the Federal Reserve act have reached, from the administrative standpoint, their full growth, and are now ready to enter upon a period of actual test through practical application.